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STATE FOR SCA/INS AND EB/TRA JEFFREY HORWITZ AND TOM ENGLE

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SUBJECT: NEW DELHI WEEKLY ECON OFFICE HIGHLIGHTS FOR SEPTEMBER
10-14, 2007

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¶1. (U) Below is a compilation of Economic highlights from Embassy New Delhi for the week of September 10-14, 2007.

NEW MORE LIBERAL AND
RATIONAL FDI POLICY
IN OCTOBER

¶2. (U) Director Gauri Singh in the Department of Industrial Policy and Promotion at Ministry of Commerce and Industry told Econoff on September 13 that the GOI will release a new FDI policy this October ¶2007. Singh said the new policy will allow for "greater liberalization and rationalization" in core sectors and essential services. In reviewing some of the important measures under consideration, the meeting highlighted following reforms under consideration:

-- Petroleum sector - removal of condition that company will have to divest 26 percent of the equity in favor of Indian partner/public within five years of commencing actual trading and marketing petroleum products. Singh highlighted that the new policy is likely to ease the FDI limit for PSU refineries.

-- Civil aviation sector - creating new supervisory body for air traffic services and formulating separate guidelines to regulate foreign investment in air traffic services, in close consultation with Ministry of Civil Aviation. There is also a proposal to allow FDI in maintenance and repair operations (MRO) and up to 100 percent investment in aviation-related services like charter flights, ground handling, and helicopter services (which are currently subject to a 49 percent FDI cap).

-- Retail sector - increasing FDI limit in companies trading single-brand products and permitting foreign investment in companies trading multi-brand products. Singh noted that before the GOI makes any decisions on opening up the retail sector to further

investment, they will wait for an ICRIER study (commissioned by GOI) to look at gains and losses from relaxing foreign investment limits in retail trading.

¶3. (U) Singh was careful not to give many details or lengthy responses to questions to avoid revealing specific details about the policy. As FDI equity inflows in India continue to increase in comparison to past years, the new FDI policy is expected to go further in streamlining the process for foreign investment to help India sustain capital flows in critical sectors. During the first quarter of 2007-08, FDI inflows totaled USD 4.9 billion as against USD 1.7 billion in the corresponding quarter of 2006-07, an increase of 185 percent. Commerce Minister Nath has also emphasized the new policy will be aimed at job creation, new investment, and "if there are any inefficiencies, will be ironed out."

SHAPING THE GLOBAL
INNOVATION ECONOMY

¶4. (U) FICCI and the Los Angeles-based Pacific Council on International Policy gathered in Delhi on September 10-11 for the first meeting of a task force of prominent buriness leaders on "Shaping the Global Innovation Economy: Enhancing Cooperation in India-US relations." The bi-national task force will look at issues to shape the global innovation economy - particularly in new technology and aerospace sectors - and identify areas of cooperation between India and US. The discussions focused on how India is no longer just a manufacturer of technology products but is becoming a promising market for technology innovation. Also, U.S. business leaders highlighted the strong cooperation in IT and with Indian-Americans, particularly on the West Coast. The task force is co-chaired by Habil Khorakiwala, President of FICCI, and Richard Celeste, former US Ambassador to India, and is expected to release their study on policy recommendation for increasing U.S.-India innovation economy trade and investment in 2008.

MUST MOVE BEYOND A
DENIAL REGIME

¶5. (U) Minister Kapil Sibal of Science & Technology and Earth Sciences opened the Task Force meetings on September 10 and focused his remarks on the "lively debate on the civil nuclear deal," which he commented is expected in any democracy. Sibal emphasized that both governments need to move away from a "denial regime" and take into consideration actual concerns, referring to dual use technologies. Today, he said, nearly all technologies can be put to dual use. Minister Sibal said that at the "heart of the nuclear deal is that it creates a gateway of opportunity ... and will help realize India's potential as a market for nuclear power." He further commented that India is a "one stop" country - "democratic and with a process to move away from denial to regulatory phase." In linking the ongoing 123 Agreement debate in India to the Task Force's broader mission of promoting global innovation, the Minister said the concept of dual use in the 21st century is a "non-starter." He also remarked on how the 123 Agreement is helping to change India's relationship with global players and noted that as soon as the 123 Agreement is signed, "India will be happy to see the U.S. and other countries stepping forward and willing to work with Indian nuclear power." The Minister also emphasized that by giving India access to nuclear fuel, the global community is increasing the potential for huge strides in the Indian economy. He tasked FICCI with drafting an Innovation Act in the next three months for the ministry's consideration to promote greater global innovation collaboration and sharing of technology make-up and research.

CREATING A KNOWLEDGE ECONOMY
WITH PPPs IN EDUCATION

¶6. (U) Deputy Planning Commission Chairman Montek Singh Ahluwalia addressed the Task Force on September 11 and focused on how the government is considering a policy to facilitate greater private

sector participation in the education sector. (Note: In a separate meeting with Commercial Counselor and Econoffs in late August 2007, Finance Joint Secretary for Infrastructure Arvind Mayaram also mentioned how the GOI is looking at public-private partnerships (PPPs) in education.) According to news reports, these policy changes are being opposed by the nodal ministry of education, the Human Resources Development (HRD) ministry, but strongly endorsed by the Planning Commission representatives who believe these change are critical in helping India evolve into a knowledge economy. Ahluwalia also confirmed that the policy would encourage foreign universities and institutions to set up collaborative institutions in India through both public and private partnerships as well as offer degrees and diplomas of same quality and standards of education as in their own countries. He said the aim is to increase India's gross enrollment ratio in higher education from the current 10 percent to 15 percent by 2014 and 21 percent by 2020, which will require a significant increase in the capacity of colleges and universities to accommodate 6 million additional students.

LETS MOVE FULL STEAM
AHEAD WITH SEZ DEVELOPMENT

¶7. (U) On September 13, 2007 at the fourth annual general meeting of the Export Promotion Council for Export Operation Units and Special Economic Zones (SEZs) units, Commerce Minister Kamal Nath appealed to the state governments to efficiently implement the SEZ policy by providing single window facilities and all other promised benefits to promoters. According to Nath, all government departments should realize that SEZs will be crucial to the Indian economy as it becomes more open, especially after a number of free trade agreements (FTAs) come into force. The Minister painted an optimistic picture of the SEZs' potential role in creating world class manufacturing facilities, increasing exports, attracting FDI,

and expanding jobs in India. According to the latest GOI data, at present SEZs - new and converted - are already providing direct employment to over 230,000 people, with over 100,000 additional jobs projected by December 2007. Nath also noted that after all the 366 formally approved SEZs become operational, 4 million additional jobs are likely to be created, and the manufacturing sector will get a big boost. Thus far, most of the employment provided through SEZs has been to the rural youth - considered by Nath and others to be the greatest contribution of SEZs to the Indian economy.

LINES DRAWN ON
ORGANIZED RETAIL

¶8. (U) The Indian Farmers Association (IFA) and the Bhartiya Udyog Vyapar Mandal (BUVM), respectively India's largest organization of farmers and largest organization of traders, announced Tuesday that they will form a pair of cooperatives to compete with organized retail if they are unable to accomplish their primary aim of keeping large retailers out of the food and grocery sector. Under this model, a cooperative of 2.5 million farmers in Uttar Pradesh, Bihar, Madhya Pradesh, Punjab, and Haryana would sell to the traders' cooperative rather than to organized retailers. Mahendra Singh Tikait, leader of the IFA, said that organized retailers might offer good prices at first to preclude competition, but eventually farmers would become dependent and organized retailers could lower prices whenever they liked. BUVM president Shyam Bihari Mishra claimed that by sourcing on this model, the trader cooperative could offer prices to compete with those offered by organized retailers. Dharmendra Kumar of India FDI Watch supported Mishra's claim. (Comment: India FDI Watch is affiliated with an anti-globalization American NGO and also orchestrated the widespread "Quit Retail" protests in India on August 9. It is possible that they suggested forming these cooperatives. End comment.)

¶9. (U) Meanwhile, in Kerala, where the communist government is pushing a modification of the Essential Commodities Act that would severely restrict the entry of organized retail, a local consumer-protection committee organized a rally of 2,000 people in support of big retailers. The Economic Times quoted committee

president Abdulla Koya as saying, "The traders are warning us to be wary of the big retailers, telling us that they will sell at low prices for five years and then hike prices. We think it is not a bad idea to get things at low prices for five years." A farmers' union in Lucknow also gathered to demand the reopening of organized retail outlets in Uttar Pradesh that Chief Minister Mayawati ordered closed on August 23.

¶10. (U) The Left parties in the central government's ruling coalition have put forward a plan to reduce the political fallout that the growth of organized retail might cause. They suggested putting a tax on each item sold by organized retailers, the proceeds from which would go into a fund used to provide affordable credit to small retailers and help them compete. The BUVM's Mishra, however, said that credit is a small piece of the problem and that the only course of action that would protect traders would be the complete ban on corporate retail.

¶11. (U) The Indian Council for Research on International Economic Relations (ICRIER), which the central government tasked with analyzing the potential impact of organized retail on small vendors, has announced that it will not endorse such a taxation policy in its upcoming report. ICRIER's preliminary findings, to be released next month, are expected to indicate (according to press reports) that organized retail does not threaten smaller stores. The report is expected to state, inter alia, that in southern India, where organized retailers have been operating for some time, small vendors' revenues have not suffered.

POWER EXPANSION HIGHLIGHTS
COAL-FIRED THERMAL

¶12. (SBU) At India Energy Forum's 10th Annual Power Forum, top GOI energy officials and heads of public and private energy companies underscored the commitment to sustain India's rapid GDP growth by expanding India's power generating capacity from its current 132,110 megawatts (April 2007) by 78,530 MW during the 11th Five-Year Plan (FYP) to over 210,000 MW by March 2012, despite India adding only 21,180 MW of its targeted 41,110 MW of capacity during the 10th Five-Year Plan of 2002-2007. With 56% of India's households still lacking access electricity, the GOI is ambitiously aiming to provide connection to all villages by 2009 and to every household by 2012. India's per capita electricity consumption is about 40% that of China, 4% that of the USA, and 22% of world average. The current gap between demand and supply is 9.9% overall and 13.5% at peak periods.

¶13. (SBU) While coal-fired thermal now makes up 53.5% (70,682 MW) of total capacity, it accounts for over 68% of electricity production due to higher plant load factors, and it will make up 52,905 MW or 67% of the total targeted incremental increase in capacity in the 11th FYP. Although the Coal Ministry has changed policies and committed to expanding coal washing and beneficiation, incentive obstacles remain to realizing the economic and environmental benefits of washing. For the several proposed coal-fired, super-critical-reactor, Ultra-Mega Power Projects of 4,000-MW, two have been awarded, a third will soon be bid, and more states are applying to the GOI to have a UMPP in their jurisdiction.

¶14. (SBU) Hydroelectric capacity is now 26% (34,654 MW) of total capacity out an estimated potential of 150,000 MW, but yields only 17% of power output due to seasonal rain fluctuations, especially on run-of-river plants, compared to dam/reservoir plants. Planned expansion of 16,553 MW during the 11th FYP will be 21% of total incremental capacity increase. Moreover, peak demand for power in the northern Indian plains, just south of the hydro capacity in the Himalayas, for pumping irrigation water occurs during the dry months (April-July) just before the monsoon, when river flow is lowest. Whereas, peak hydro production is during and after the monsoon, when power demanded by irrigation is lowest. The Ministry of Power has expanded relocation and compensation packages for people displaced by reservoir/dam hydropower projects.

¶15. (U) Natural gas fired thermal plants, based on domestic production and imported liquefied natural gas, now provide about 10% (13,692 MW) of capacity and about 10% of output, but will make up only 4,242 MW or 5.4% of new incremental capacity in the 11th FYP. A large share of current natural gas fired power capacity is idle due to natural gas shortages. Expected new offshore gas output from the Krishna Godavari basin is expected in the market by early 2009, but domestic and foreign producers remain concerned about getting common carrier access at transparent prices to natural gas pipelines and about future government control over gas allocation prices to final consumers.

¶16. (SBU) Nuclear power is now about 3% (4,120 MW) of capacity and about 3% of total output, with 3,380 MW planned for the 11th FYP or 4.3% of the incremental increase. Prospects for nuclear energy's growing share have improved with the progress on the U.S.-India Civil Nuclear Agreement.

¶17. (SBU) Wind power continues to have regional prospects, but is constrained by low load factors and the lack of substation facilities for evacuation of power. India now has the fourth largest installed wind power capacity in the world after Germany, United States, and Denmark. Out of the total installed capacity of approximately 9,000 MW of grid interactive renewable power in India, wind power accounts for a major share - 7,028 MW (March 2007) or about 5.4% of total power capacity. Estimates put India's wind power potential at 45,000 MW. However, low load factors or capacity utilization factors averaging about 22% mean wind power contributes only about 2% of total power output.

Load factors of 35% are being achieved in a few isolated cases with the use of high efficiency low speed wind machines, sub-transmission facilities and better synchronization with the typically unstable Indian grids.

¶18. (U) Visit New Delhi's Classified Website:
http://www.state.sgov/p/sa/newdelhi

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